

THE

*Neal Spelce*

# AUSTIN LETTER

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Volume 23, Number 27

October 5, 2001

Dear Client:

**“Make An Offer.” “No Reasonable Offer Refused.” It’s been more than ten years since those phrases have been heard in Austin office leasing circles. But, they are now being uttered as there are reports of some leases made earlier this year already turning into subleases.**

More than 2.5 million sq.ft. of sublease office space is on the market right now according to **Mike Buls** of Buls/Hodge Consulting. To give you an idea of how much space that growing figure represents, consider this: the planned 33-story office building at 4<sup>th</sup> And Congress Avenue contains 510,000 sq.ft. **Five times the office space in a 33-story building is available for subleasing.** Obviously, this is a significant number.

This is driving down office lease rates. **Bill Wendlandt’s** Office Leasing Advisors (OLA) reports “rental rates for this sublease space were often below the lease rates being paid by the master tenants, and some of it was **as much as \$15/sq.ft. below what comparable direct space leased for earlier in the year.**”

You want specifics? OLA reports **Frost Plaza, in the shadow of the State Capitol downtown, had 3,000-20,000 sq.ft. sublease space available at \$18/sq.ft. The direct rate is \$33/sq.ft.** What about northwest? Bridgepoint Square, has 6,000-20,000 sublease space available at \$19/sq.ft., while the direct rate is \$35/sq.ft. Also northwest: 8303 MoPac has 12,000 sq.ft. sublease space available and the asking price is “make an offer” for space that has a 2001 direct rate of \$31/sq.ft.

The situation is uneven throughout the area. **“The majority of this space continued to be in the northwest sub-market,** where construction was suspended on one building, and three others (totaling 550,000 sq.ft.) remain vacant and/or un-leased,” OLA reports. “In contrast, the southwest sector continued with relatively strong conditions. Historically the last sector to feel the effects of a downturn, the southwest had **only 10% of the city’s sublease inventory,** compared to the northwest which had 67%.”

Of course, subleasing from a company that is scaling back could be fraught with peril. OLA advises subleases should be structured so they **remain in effect in the event the master tenant defaults on the master lease.** “This is a critical, yet often overlooked, component of any sublease,” OLA notes.

**With so much low-priced sublease office space on the market in Austin, what about major office construction projects? You can still see vast amounts of construction downtown. What's happening to those high-dollar ventures?**

Three high-profile office buildings are in varying stages of construction in the Central Business District. **Helen Jobs**, a commercial real estate specialist (formerly with Trammell Crow, now with her own Gold Eagle Investments), notes **Carr America's high-rise at 300 West Sixth is scheduled for completion by the end of the year and is 55% pre-leased.** This building started with three major tenants – two law firms (Clark, Thomas and Akin, Gump) and a home grown venture capital company (Austin Ventures). All systems are go for this structure.

The other very visible downtown construction project is the two-building low-rise complex that flanks a big hole in the ground, which will someday be Austin's new City Hall on the north bank of Town Lake. With much fanfare, **Computer Sciences Corporation** accepted an incentive package from the City and began building before the bust took hold. CSC is now moving into its buildings, but announced some time ago it would sublease space it wasn't prepared to occupy. So far, reports Office Leasing Advisors (OLA), they **"have no takers for their 111,000 sq.ft. of sublease space."**

That leaves a ghost building sitting empty downtown. "Intel has received a substantial amount of negative press by stopping construction on its 400,000 sq.ft. building while it decides what to do," Jobs observed. "Despite receiving numerous unsolicited offers, **Intel remains in a holding pattern.**"

What about the sparkling new high-rise that was announced at Fourth and Congress Avenue? What's the status of this planned 33-story, 510,000 sq.ft. building? OLA points out developers announced **site demolition would begin this fall.** Another big law firm, Winstead, Secrest, was announced as a lead tenant in the building that had an original target date for completion in late 2003. We'll watch for the beginning of demolition before predicting progress.

**How does the value of Austin office buildings stack up these days?** Commercial real estate specialist **Helen Jobs** points out that in 1999, 24 office properties over 30,000 sq.ft. sold with an **average selling price of \$136/sq.ft.** "The year 2000 brought increased activity with 27 buildings selling for an **average per square foot price of \$145,**" she said. Jobs noted prices in 2000 ranged from \$85/sq.ft. for Class C properties occupied to \$184/sq.ft. for new suburban construction.

Now, she said, with "projections of flat or decreasing rental rates," the average per square foot price for eleven buildings sold so far this year is only \$119/sq.ft. "Although there are an abundance of buyers, the spread between what sellers want and what buyers are willing to pay is growing. **Many buyers feel there will be some opportunities at the end of this year and into next year and have a wait-and-see attitude,**" Jobs observed.

**Relentless. The economy and its competitors may be staggering, but Dell Computer just keeps pounding away with a new marketing push in its drive to dominate.** Did you happen to see Dell's new TV spot in "Monday Night Football" this week? Or the new ads in *The Wall Street Journal* and other newspapers? This major national ad push launched Monday promotes servers, storage systems, applications, operating systems and tech services.

This new onslaught is designed to convey the specific benefits of Dell's direct sales model to **medium and large businesses, many of which have delayed purchases of computer products and services due to the current economic conditions.** How much is Dell spending on this ad blitz? Dell won't say, but ad industry sources point out Dell spent \$97.9 million in the first six months of 2001 in measured media and its annual ad budget is pegged at \$200 million. You do the math and, even if it's off somewhat, we're talking about a healthy chunk of change.

*Advertising Age* magazine suggests the weakened climate for tech spending makes Dell's campaign all the more relevant. It quotes **Scott Helbing**, Dell's VP/Global Brand Strategy (who says Dell "owns" the Direct Business Model), this way: "The business model **allows us to produce products cheaply, and if customers have less money, they have to make it work harder.** That's when we think the direct model is at its best."

By the way, *Ad Age* points out what we have been telling you for some time now: Dell's strengths and momentum give it an edge over rivals. **Consider this: Dell's \$47 billion market capitalization is greater than the combined values of rivals Hewlett-Packard, Compaq Computer and Gateway.** Then, late this week, Dell surprised analysts when it reaffirmed it would meet 3<sup>rd</sup> quarter earnings projections. This is all significant when you consider there is no single company more important to the Austin economy than Dell, our largest private-sector employer whose stock is widely held throughout the community.

**We're getting word from Washington that the Bankruptcy Reform Act of 2001 is on the back burner and no action is expected until the economy improves.** This is important because Texas is one of only five states (the others: Florida, Iowa, Kansas and South Dakota) that **prevent creditors from seizing your homestead in bankruptcy court – no matter the value of the home.**

Before bankruptcy reform was put on the shelf for the time being, both the USHouse and USSenate, by huge margins, **capped the amount of home equity that could be shielded from creditors at \$100,000 (House) and \$125,000 (Senate).** To understand the relevance of this bill, all you have to do is gaze at the hills around Austin and look at the hundreds of million-dollar homes built during the past few years. Many living in those mansions are now seriously suffering from declining stock portfolio values. And the resale market for million dollar homes in the Austin area has declined precipitously.

**When the Federal Reserve Board dropped interest rates this week to the lowest level since John F. Kennedy was president, you immediately start wondering how low can they go. What's the floor? The best we can determine, interest rates have not hit bottom.**

The Fed moved aggressively when, for the 2<sup>nd</sup> time in two weeks, it slashed short-term interest rates Tuesday a half-point. What does this mean for you, if you're a borrower? Well, almost immediately, **major banks cut their prime rate a half-point to 5.5%**. As you know, banks will now use the new 5.5% prime rate as a benchmark to set your business and consumer loans.

And it's likely to dip even lower before year's end. While nothing is certain in these uncertain times, the best information we can get from Washington predicts **the Fed will drop the rates a quarter-point next month and maybe another quarter-point in December**. That should be the floor. But, hey, a 5% prime rate is an unbelievably low floor. For your planning, **if you need a short-term business or personal loan, the time to lock in the best rate is between now and year-end**. By the way, *long-term* rates are not going to move very much.

**If you can get over the fear of flying, now's the time to lock in some amazingly low air travel fares. And, if you can get in a frame of mind to arrive earlier than normal at your airport, you can probably have some of the most hassle-free air travel you've experienced in years.** The airlines got very competitive this week – dropping business fares as much as 50% and offering special on-line getaway fares below what they were a year ago. And, it's not crowded.

CORRECTION: In our report to the Post Office last week, two numbers were off by a single digit. We reported: "...137 were paid mail subscribers, 10 were distributed free." It should have read: "...136 were paid mail subscribers, 11 were distributed free." Our apologies to the P.O.

**Dr. Louis Overholster** has had so many financial ups-and-downs he's now listed on the NASDAQ.

NEAL SPELCE AUSTIN LETTER (ISSN 1071-0612) is published weekly, except last two weeks of the year, for \$150 (plus tax) per year or \$249 (plus tax) for two years. To subscribe, call 512-498-9495. Periodical Postage Paid at Austin, TX 78767 by Austin Letter, Inc., 1407 Wild Cat Hollow, Austin, TX 78746. POSTMASTER: Send address changes to: Neal Spelce Austin Letter, P.O. Box 1905, Austin, TX 78767-1905.

Sincerely



Editor/Publisher